



Economic Update

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Economy Growing Strongly – But Payroll Jobs Numbers Remain Perplexing

On nearly every important score, data show the U.S. economy is growing strongly, with a broad-based expansion occurring across the various sectors. One exception is payroll jobs growth. Despite historical highs for several key indicators, payroll jobs growth has shown only modest gains over the past 5 months. In a broader sense, signals from the labor market continue to be confusing, as the unemployment rate declined significantly over the past 6 months, indicating ongoing improvement in labor conditions.

Despite these recent labor market uncertainties, the economy is expected to continue growing at a fairly strong pace during 2004 and through 2005. Labor markets also are expected to improve substantially, with further declines in the unemployment rate and significant payroll jobs growth.

Data Show Strong Economic Activity

At this time last year, the Nation faced a “backdrop of economic uncertainty – uncertainty about the investment outlook, the strength of the economic recovery, and the international environment” (*Economic Update*, January 2002). With the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2003, and the ouster of Saddam Hussein’s regime in Iraq, much of the uncertainty was eliminated and the U.S. economy made a substantial transformation during 2003.

- **Real growth:** Real gross domestic product [GDP] is expected to have grown at a 4.4-percent rate during 2003, up from 2.8 percent during 2002 and 0.0 percent during 2001 (the first estimate of GDP for 2003’s fourth quarter will be released later this month). Real GDP growth surged to a 20-year high of 8.2 percent in the third quarter of 2003. According to the Blue Chip survey, growth is expected to continue at 4.1 percent during 2004 and 3.5 percent during 2005.

- **Stock market gains:** With the resolution of many of last year’s “geopolitical uncertainties” – and with the passage of the reductions in capital gains and dividend tax rates – stock markets rose strongly from March through December. During 2003, the Dow Jones Industrial average rose 25 percent; the Standard & Poor’s 500 Index rose 26 percent; and the NASDAQ composite index rose 50 percent.
- **Investment and manufacturing turnaround:** At the beginning of 2003, data generally showed that business investment and the manufacturing sector were continuing to struggle or were declining outright: real fixed business investment spending had even declined for nine straight quarters. In contrast, the current view is much better: business investment increased strongly during the year, manufacturing activity surged to its highest level in 20 years in December, manufacturers’ orders and shipments increased sharply over the final 6 months, and industrial production is rising.
- **Confidence and sentiment:** Following the 10-year lows reached in the early part of the year, consumer confidence rebounded to a level that historically has been associated with economic expansion. Similarly,

Blue Chip Economic Outlook, January 2004

	2003.3	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	<i>Actual</i>		<i>Projection</i>							
Real GDP Growth	8.2	4.3	4.4	4.2	4.0	3.8	3.6	3.5	3.5	3.4
Unemployment Rate	6.1	5.9	5.9	5.8	5.7	5.6	5.5	5.5	5.4	5.4
CPI Inflation	2.4	1.3	1.7	1.8	1.9	2.0	2.1	2.2	2.2	2.3
3-month Treasury Bill	1.0	0.9	1.0	1.2	1.4	1.7	2.1	2.4	2.8	3.1
10-year Treasury Note	4.3	4.3	4.4	4.6	4.9	5.0	5.2	5.4	5.5	5.5

Note: Unemployment and interest rate values for 2003.4 are actuals and not projections.

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business confidence has improved markedly: for example, the National Federation of Independent Business index of Small Business Optimism rose in November to its highest level in 20 years.

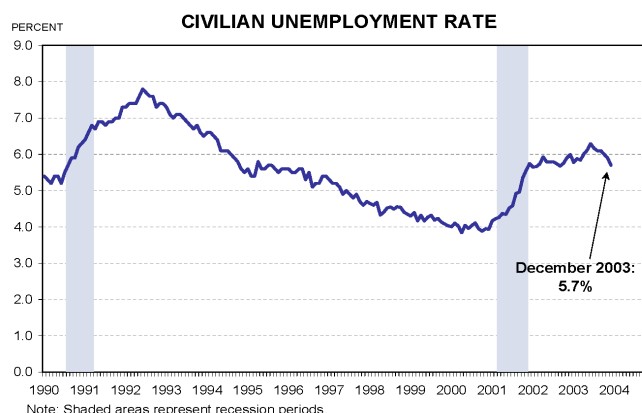
- *Other indicators:* Other data, including consumer spending and residential investment, show that the economy is growing strongly. Consumer spending has been remarkably resilient over the past several years, continuing to grow throughout the recession and slow growth period. The gains in consumption were aided by the 2001 and 2003 tax cuts, which boosted households' "disposable" after-tax income.

Confusing Labor Market Data Continue

In a good sign for improving labor markets and a growing economy, the unemployment rate has declined steadily, falling from its high last June of 6.3 percent to 5.7 percent in December – a level equivalent to that observed in the midst of the 1990s' expansion (see chart). In contrast, payroll employment rose by only 1,000 jobs in December, bringing the total increase over the past 5 months to 278,000, an average of roughly 55,000 a month. (Jobs gains for the expanding economy should be about 150,000 to 175,000 a month. See *Budget and Economic Monitor*, October 2003.)

Several explanations exist for these apparently conflicting results:

- *Different data sources:* The unemployment rate and the payroll jobs estimates are derived from two different surveys: the unemployment rate is from the "household" survey and is based on responses from 60,000 households, classifying people as employed, unemployed, or not in the labor force; the payroll jobs estimate is derived from the "establishment" survey, based on information from 160,000 businesses and government agencies covering 400,000 worksites. Hence, one survey counts "people" in the population, the other counts the number of jobs at business establishments and in government.
- *Different coverage and data errors:* The household employment numbers count all employed individuals, including some not captured in the establishment survey: agricultural workers, the self-employed, unpaid family workers, private household workers, and individuals on unpaid leave. A large increase in self-employed individuals may be an important part of the



explanation. Evidence also exists that the establishment survey tends to initially miss some of the employment gains early in the business cycle, and then only captures them with subsequent data revisions. Such errors appear to be related to employment in new businesses that are not yet in the establishment survey. A recent survey from the National Federation of Independent Business supports this view: net hiring plans by small businesses surged in December to a near-record high and the highest level since 1999. Also, unemployment insurance claims have declined recently to levels typically associated with significant jobs gains in the 125,000 to 150,000 range.

- *Unsubstantiated claims:* Some media reports and analysts have tried to claim that the unemployment rate decline in December only occurred because "discouraged" workers left the labor force. No hard evidence exists to support that claim. The labor force data are inherently volatile, and month-to-month movements cannot easily be explained. In fact, the government's reported series on "discouraged" workers actually declined in December, and was little changed from December of the previous year. The identified reasons individuals of prime working ages are not in the labor force include: illness or disability, retirement, going to school, home responsibilities, could not find work, and "other" – with the "could not find work" category often the smallest percentage of all.

In sum, the declines in the unemployment rate and in unemployment insurance claims, the improved outlook for hiring by small businesses, and the outlook for further strong economic growth, all point to continued improvement in the economy and in labor markets. Nonetheless, the lagging performance of payroll jobs remains a concern.

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